Supreme Court, U.S.
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No. 87-71

In the Supreme Court of the United States

October Term, 1987

In Re: Ozark Restaurant
Equipment Co., Inc.
Jill R. Jacoway,
Successor Trustee ..... *Petitioner*

V.

Bruce Anderson, Elmer Dale
Yancey, Kenneth Eads,
Robert Whiteley and
Anderson's Cajun Wharf ..... *Respondents*

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

BRIEF IN OPPOSITION FOR THE RESPONDENT

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QUESTION PRESENTED

DOES A BANKRUPTCY TRUSTEE IN A CHAPTER 7 LIQUIDATION OF A DEBTOR CORPORATION HAVE STANDING TO BRING AN ALTER EGO ACTION SOLELY ON HER OWN INITIATIVE AGAINST THE FORMER SHAREHOLDERS AND DIRECTORS OF THE DEBTOR CORPORATION?

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STATEMENT OF THE CASE

The respondent accepts the petitioner's statement of the case as far as the basic procedural accuracy is concerned. However, there are several factual disputes which have not yet been resolved, and these must be mentioned specifically lest it be assumed that the respondents agree with the trustee's assertion that they abused the corporate form of the debtor.

On remand from the District Court (see *In re Ozark Restaurant Equipment Co., Inc.*, 61 B.R. 750 (W.D. Ark. 1986)), the Bankruptcy Court was to make a determination as to whether the respondents could be held liable under §547 or §548 of the Bankruptcy Code for any amounts held to be owing to the debtor's estate. The bankruptcy court found for the trustee on several causes of action, all of which are now on appeal to the District Court. Crucial to the determination of these issues is whether the sales of restaurant equipment and supplies made by the debtor to the respondent's other businesses were for a reasonably equivalent value.

The trustee asserts and the lower court found that an average markup of 30% was standard in the industry for restaurant equipment sales. However, the basis for this factual finding is not supported by the testimony in the record. The trustee's own expert testified that a company could operate on a 20% average markup. Furthermore, the trustee's assertion and the finding of the bankruptcy court that the debtor only charged a 7% markup on sales to the respondent's other businesses is also erroneous. The record clearly shows that a 10% markup was charged, and that only on two or three isolated sales was a markup of less than 10% used.

The trustee also misled the court below when it was asserted that sales tax was not charged to Anderson entities. The trustee's own evidentiary exhibits clearly reflect that a 4% sales tax was charged on sales made by the debtor to Anderson entities. And as for the assertion that "typical markups for other Ozark customers was between twenty-eight and ninety percent"—this is simply a misstatement of the facts. True, evidence was introduced to show that at least one sale was made for a 28% markup and another one for a 90% markup, but these were not shown to be representative sales. Indeed, evidence was also introduced to show that on at least one occasion the debtor sold equipment for a 10% markup to another customer.

As for the trustee's assertion that the respondents had prepared "fraudulent balance sheets to entice suppliers to sell merchandise to Ozark on credit", there was testimony at trial that these balance sheets were not used to represent the assets of the debtor. Significantly, aside from bare assertions by the trustee, there was no creditor who testified at trial that they had been sent one of these alleged fraudulent balance sheets or relied on such a balance sheet before extending credit to Ozark. (*In re Ozark*, 61 B.R. at 752).

Also, the Court below found that all sales to the respondent's other businesses comprised only 23 percent of the debtor's total sales. (*In re Ozark*, 61 B.R. at 752). Surely this cannot be a sufficient basis for holding the respondents liable for all the debtor corporation's bad debts, many of which were due to other factors including the bad business judgment of the debtor's president, Mr. Eads.

In short, there are a number of factual issues which have not yet been resolved, and which the respondents argue will preclude any recovery from them on an alter ego theory in any event, since they did not abuse the corporate form of the debtor. These matters are brought to the Court's attention only because the trustee paints such a one-sided picture in her statement of the case.

SUMMARY OF THE ARGUMENT

In the first place there is no conflict between the issue decided in this case by the Eighth Circuit Court of Appeals and any other Circuit Court of Appeals decision. The petitioner's reliance upon the holding of the Fifth Circuit in *In re S.I. Acquisition*, 817 F.2d 1142 (5th Cir. 1987), as being in conflict with the decision of the Eighth Circuit in the instant case is unfounded. The issue in *S.I. Acquisition* (supra) was not whether the trustee had standing to assert an alter ego action on her own, but whether section 362 of the Bankruptcy Code would operate to stay a state court action by a creditor of the debtor against entities affiliated with the debtor corporation. Therefore the issues decided by the Eighth Circuit and the Fifth Circuit were clearly not the same and a conflict does not exist.

Furthermore, the trustee's powers under Section 544, the strong-arm clause, are determined by applicable state law. The District Court and the Eighth Circuit Court of Appeals correctly held that in Arkansas an alter ego action is personal to creditors of a debtor corporation and that therefore a trustee, as the representative of the debtor, does not have standing to bring an alter ego claim on her own without creditor intervention. The trustee's assertion that *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1971), is not controlling on this issue is also erroneous. *Caplin* (supra) denied standing to the trustee in a Chapter X proceeding to bring an alter ego claim on behalf of the bankrupt corporation's creditors (debenture holders) against a third party, the indenture trustee. The Court recognized that the legislature was empowered to grant such standing to a bankruptcy trustee and specifically invited Congress to do so at the close of that opinion.

However, as the Eighth Circuit Court of Apeals is careful to point out, when the overhauled Bankruptcy Code was enacted in 1978, a specific provision which was passed by the House of Representatives (Section 544 (c)) was

deleted before promulgation of the final version of Section 544. Since Section 544 applies to both reorganization and liquidation trustees, there can be no other interpretation of Congressional intent than that Congress did not give standing to bankruptcy trustees to assert alter ego claims without creditor intervention. Therefore, the rationale of *Caplin* (supra) also controls the instant case.

REASONS FOR DENYING WRIT

I.

THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS IS NOT IN CONFLICT WITH OTHER APPELLATE COURT DECISIONS.

The trustee asserts in her brief that the decision of the Eighth Circuit creates an intolerable conflict with other appellate court decisions. However, she cites no case, nor has an exhaustive research by the respondent found a case, wherein another Circuit Court of Appeals decision is in direct conflict with the Eighth Circuit's opinion denying a bankruptcy trustee standing to bring an alter ego action against former shareholders and directors of a debtor corporation.

The trustee's reliance on the Fifth Circuit Court of Appeal's decision in *In re S.I. Acquisition, Inc.*, 817 F.2d 1142 (5th Cir. 1987) as a basis for her claim of a conflict between the Circuit Courts of Appeal is misplaced. In that case the 5th Circuit did reverse the lower court's decision, but the issue in *S.I. Acquisition* was not whether the bankruptcy trustee had standing to assert an alter ego action on her own, but rather the issue was "whether the prosecution of a state court suit that is premised solely upon the theory that the defendants therein are the controlling entities or persons of a chapter 11 debtor (and thus accountable for the debtor's debts) is automatically stayed as to all parties involved by section 362(a)(1) or (3) upon the filing of the debtor's bankruptcy petition." *In re S.I. Acquisition*, 817 F.2d at 1150. Furthermore, the *S.I. Acquisition* case was concerned with a Chapter 11 bankruptcy proceeding and the court felt that to allow the plaintiff to pursue its state court action would abridge "the general policy of giving the debtor and its control persons the opportunity to reorganize its finances." *In re S.I.*

Acquisition, 817 F.2d at 1154. Nowhere in the opinion does the 5th Circuit hold that a Chapter 7 trustee in a corporate liquidation has standing on her own to bring an alter ego action. There appears to be no Circuit Court of Appeals decision dealing with the specific issue involved in the instant case. Therefore the trustee's assertion that there is an "intolerable conflict with other appellate court decisions" is unfounded.

After careful consideration of the Arkansas Supreme Court's decisions on piercing the corporate veil, the 8th Circuit held that "Because the corporate entity will be disregarded under Arkansas law only if it has been abused to the detriment of a third person, and because the nature of the alter ego theory of piercing the corporate veil makes it one personal to the corporate creditors rather than the corporation itself, it is axiomatic that the claim does not become property of the estate under Section 541(a)(1), nor is it enforceable by the trustee under Section 704(1)." *In re Ozark Restaurant Equipment Co., Inc.*, 816 F.2d 1222, 1225 (8th Cir. 1987).

The Bankruptcy Court decisions which the trustee cites in her brief in support of her contention that the trustee has standing to assert an alter ego action on her own, as well as the 5th Circuit opinion in *S.I. Acquisition* (supra), are based on state law as much as on those court's interpretations of the Bankruptcy Code. *In re Mortgage American Corp.*, 714 F.2d 1266 (5th Cir. 1983), which the trustee cites to support her point, also concerned the automatic stay provisions of the Bankruptcy Code and a state court action by a creditor off the debtor outside of bankruptcy. The Texas state law on piercing the corporate veil was crucial to the decision. "The relationship between the new Bankruptcy Code and the various state law causes of action assertable by creditors in state court is, as we have already intimated, both complex and determinative of the outcome of the present litigation." *In re Mortgage America*, 714 F.2d at 1273. That court goes on to say that "the scope of

the automatic stay under section 362 depends upon how the Texas Courts would characterize a cause of action under the trust fund (denuding) theory. If an action under that theory belongs, under Texas law, to the corporation, then the action is "property of the estate" and the bank may not pursue it." *In re Mortgage America Corp.*, 714 F.2d at 1276. The Court held that "Under Texas law the action is in the right of the corporation and, as such, is "property of the estate" within the meaning of section 541(a)(1) of the Code. The automatic stay therefore applies." *In re Mortgage America Corp.*, 714 F.2d at 1277.

Although the trustee is careful to point out that both Texas and Nevada seem to allow an alter ego action by the trustee in bankruptcy by citing this Court to *In re S.I. Acquisition*, 58 B.R. 454 (Bankr. W.D. Tex. 1986), rev'd, 817 F.2d 1142 (5th Cir. 1987), and to *In re Western World Funding Inc.*, 52 B.R. 743 (Bankr. D. Nev. 1984), she fails to point out—even though all of those courts did so in their opinions—that at least two other states have decided the issue differently. See *Stodd v. Goldberger*, 73 Cal. App. 3d 827, 141 Cal. Rptr. 67 (1977), and *In re Green Valley Seeds, Inc.*, 27 B.R. 34 (Bankr. D. Ore. 1982). Both California and Oregon have held that a bankruptcy trustee may not pursue an alter ego action on her own because under state law that cause of action is personal to creditors and does not belong to the corporation.

Arkansas law, as interpreted by the District Court and the 8th Circuit Court of Appeals in the instant case, likewise does not allow the trustee to pursue such a cause of action unless a creditor joins in the suit. This was exactly the situation in *Henderson v. Rounds & Porter Lumber Co.*, 99 F. Supp. 376 (W.D. Ark. 1951). Both the District Court and the 8th Circuit opinions point out that *Henderson* is a different situation than ~~when~~ the trustee asserts an alter ego claim on her own. The Eighth Circuit also points out that although some states may permit a trustee to bring an alter ego action on her own without a creditor joining,

Arkansas does not. (*In re Ozark*, 816 F.2d at 1226, N. 7). Furthermore, as that court points out, the trustee could have brought the alter ego claim and avoided the standing requirement by having one of the debtor's creditors join in the suit. In this case the creditors were asked to join in the suit but none of them wished to do so. (*In re Ozark*, 816 F.2d at 1223, n. 3.) It is beyond comprehension why the trustee should be allowed to bring this claim when the very creditors who would benefit by any recovery, after the trustee's fees and all other administrative expenses are paid, refused to join in such a suit.

II.

THE EIGHTH CIRCUIT'S DECISION IN THIS CASE WILL NOT ADVERSELY AFFECT FEDERAL BANKRUPTCY LAW, AND IN FACT THE DECISION QUESTIONED HEREIN IS A CORRECT INTERPRETATION OF THE TRUSTEE'S LACK OF STANDING TO BRING AN ALTER EGO ACTION AS REFLECTED BY THE REQUIREMENTS OF ARTICLE III OF THE UNITED STATES CONSTITUTION AND THE INTENT OF THE LEGISLATURE IN REVISING THE BANKRUPTCY CODE.

The Trustee asserts in her brief that the holdings of the District Court and the Eighth Circuit Court of Appeals were based in a large part on the Court's holding in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1971). While this may be true of the District Court's opinion, the same cannot be said of the holding of the Eighth Circuit. That court made an exhaustive research of the legislative history of the new Bankruptcy Code and the pre-code decision of *Caplin* (supra), concluding that since Congress had failed to enact a proposed Section 544(c) which would have specifically overruled *Caplin*, (see notes 9 and 10 of the 8th Circuit's opinion—816 F.2d at 1227-28) that therefore "Because subsection (c), as part of Section 544, would have applied to both reorganization and liquidation trustees, and because Congress refused to enact subsection (c), we believe

Congress' message is clear—no trustee, whether a reorganization trustee as in *Caplin* or a liquidation trustee as in the present case, has power under Section 544 of the Code to assert general causes of action, such as the alter ego claim, on behalf of the bankrupt estate's creditors." *In re Ozark*, 816 F.2d at 1228.

This respondent cannot improve on the logic or the analysis of the Eighth Circuit's opinion regarding the intent of Congress and the legislative history of section 544 of the Bankruptcy Code in the wake of the *Caplin* decision. Suffice it to say that it is impossible to imagine a more accurate interpretation of Congress' inaction after the *Caplin* Court's explicit invitation for Congress to give a trustee the standing which is sought in this case.

There are also practical reasons why a bankruptcy trustee should be denied standing to assert an alter ego claim. As the District Court pointed out:

> "In a Chapter VII proceeding, giving (the trustee) such standing creates a situation rife with conflicts, conflicts which can only be resolved if the creditors alone are recognized as proper parties plaintiff in an alter ego proceeding.
>
> One of the duties of a Chapter VII trustee is to "examine proofs of claims and object to the allowance of any claim that is improper." 11 U.S.C. §704(4). One of his duties, then, is to whittle the number of unsecured claims against the estate. If, however, a third party exists who is "good" for the claims, the trustee has no motive to pursue his duties under §704(4). In fact, given that his compensation depends on the size of the estate, he actually has an interest in allowing as many claims as possible so that the recovery, and his compensation, is as large as possible." *In re Ozark Restaurant Equipment Co., Inc.*, 61 B.R. 750, 757 (W.D. Ark. 1986).

The trustee's brief to this Court in support of her petition for certiorari actually supports the District Court's

analysis of this conflict. The trustee asserts that "the essence of an alter ego claim is that it seeks to tap a pool from which to satisfy its claims against the Debtor. This "pool" is made up of the assets of the alleged alter ego . . . . We think that it is safe to assume that this "pool" is infinite." (Trustee's Brief at page 15.)

Obviously the trustee believes that these respondents have infinite resources with which to satisfy any and all claims against the bankrupt estate, thereby negating any motive the trustee may have had to otherwise examine more closely those claims asserted against the estate and to object to those which may have no merit. This is precisely the sort of conflict between the trustee's duty to investigate claims against the estate and an alter ego action to which the District Court referred.

The Eighth Circuit also points out that the *Caplin* Court's concern with whether creditors would be bound by any settlement or decision rendered in favor of the trustee is also applicable in this case. "If the trustee in the instant case was allowed to pursue and recover on the alter ego cause of action on behalf of Ozark's creditors, there obviously would be questions as to which creditors were bound by the settlement. (Citations omitted). This is because the trustee is not the real party in interest, and thus does not have the power to bind the creditors to any judgment reached in the litigation." *In re Ozark*, 816 F.2d at 1230.

Finally, there is another practical concern which was raised by the District Court in the instant case. If a trustee in a reorganization does not have standing to assert an alter ego claim when it would obviously be beneficial to the corporation in terms of lightening the debtor corporation's repayment plan, then why should the trustee have such power in a Chapter VII liquidation? "At least in the former instance, an interest of the entity is being addressed. In a Chapter VII case, only creditor interests are being asserted." *In re Ozark*, 61 B.R. at 753.

CONCLUSION

For all the foregoing reasons, the respondents respectfully request that the Court deny the trustee's Petition for a Writ of Certiorari.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Raymond C. Smith, hereby certify that I have served a true and correct copy of the above and foregoing document on all parties listed below by placing same, postage prepaid, in the U.S. Mail this 12th day of August, 1987.

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